Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
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No. 86-1518

IN THE

Supreme Court of the United States

October Term, 1986

STANDARD MANUFACTURING CO., INC.,
Appellant,

against

TAX COMMISSION OF THE STATE OF NEW YORK and RODERICK G.W. CHU, FRANCIS R. KOENIG and MARK FRIEDLANDER, acting as the Tax Commission of the State of New York,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK.

MOTION TO DISMISS OR AFFIRM

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Dated: April 14, 1987

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Question Presented.

Whether the provisions of New York State Tax Law §211(4) by requiring New York parent corporation to file a combined franchise tax report with its subsidiary, which conducts business in Puerto Rico, in order to reflect New York tax liability properly, violate the Supremacy, Due Process and Equal Protection Clauses of the United States Constitution.

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MOTION TO DISMISS OR AFFIRM

The appellees move the Court to dismiss the appeal or, in the alternative, to affirm the judgment of the Court of Appeals of the State of New York on the ground that it is manifest that no substantial Federal question is raised by the appeal.

State Statute Involved

Under New York Tax Law, § 211(4) and the regulations promulgated under its provisions, the New York State Tax Commission is authorized to require a corporation to file a tax report on a combined basis with another corporation where it appears that: a corporate taxpayer owns all the capital stock of the other corporation; such report is deemed necessary, because of intercompany transactions of the corporations, to reflect properly tax liability under Tax Law Article 9-A; and each corporation required to be included in the combined report is in substance part of a unitary business conducted by the group. In such a tax report, the combined entire net income of the corporations are reported, allocated within and without New York under a three-factor formula, and the New York allocated income forms the base on which New York tax liability is computed. New York Tax Law, § 210(3).

Statement of Facts

The appellant, Standard Manufacturing Co., Inc. (Standard), is a New York corporation with its principal place of business in New York and is engaged in the manufacture, purchase and sale of clothing. It wholly owns Caribbean Outwear Corporation (Caribbean) which is a Delaware corporation that has its principal place of business in Jabuyoa, Puerto Rico. Caribbean manufactures and sells "activewear" clothing designed for wear by persons engaged in somewhat strenuous physical exercise. During the years in issue, fiscal years ended July 31, 1978 and July 31, 1979, Caribbean sold 90% of its products to Standard, Caribbean's advertising was minimal, consisting of two listings in local directories and little effort was made to sell its products to anyone else.

The appellees, New York State Tax Commission, following an administrative hearing, sustained a tax deficiency issued to Standard for the years in issue which resulted from requiring Standard to file combined corporate franchise tax returns with Caribbean in order to reflect New York corporate franchise tax liability properly. Standard at the administrative hearing contended that it had adjusted its prices to reflect arms length pricing with Caribbean as a result of an agreement made with the United States Internal Revenue Service and that, as a result, Caribbean's income was not distorted. The agreement was reached after a tax audit was conducted by the Internal Revenue Service of Standard and Caribbean for years prior to the years in issue here. The New York Tax Commission found that repeated changes as a result of Federal audits evidenced a pattern of unrealistic pricing between Standard and Caribbean which were corrected only after audit and that the presence of distortion may be inferred as to income or losses not specifically reviewed by Federal auditors (Petr Jur State 25, 29).

The New York Supreme Court, Appellate Division, Third Department, in its unanimous decision (114 N. Y. A. D. 2d 138), found that there was sufficient evidence to support the Tax Commission determination. On December 16, 1986, the Court of Appeals of the State of New York summarily affirmed the judgment of the Appellate Division for the reasons stated in that court (69 N. Y. 2d 635 [1987]).

ARGUMENT

The appellant does not raise a substantial Federal question.

The appellant's contentions that New York is preempted from requiring the inclusion of income of Caribbean with

that of Standard in a combined report by the provisions of Internal Revenue Code, § 936, and that it is in violation of the Supremacy Clause of the United States Constitution (U. S. Const., art VI, § 2) are manifestly unsubstantial. A state's taxing power is not conferred by the Federal Constitution but exists independently of it. *People ex rel. Hatch v. Reardon,* 184 N. Y. 431 (1906), *affd.,* 204 U. S. 152 (1907). It has long been recognized that "historic * * * powers of the States [are] not to be superseded" by Federal law, "unless that was the clear and manifest purpose of Congress". *Rice v. Santa Fe Elevator Corp.,* 331 U. S. 218, 230 (1947). *Accord, e.g., Ray v. Atlantic Richfield Co.,* 435 U. S. 151, 157 (1978). There is no constitutional prohibition which prevents states from requiring corporations to file combined reports with foreign or alien corporations which are engaged in a unitary business within and without the several States. *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159 (1983).

Under New York Tax Law, § 211(4), the Tax Commission may require the filing of a combined tax report only where it deems such a report necessary "in order properly to reflect tax liability" under Tax Law, Article 9-A. In taxing corporations doing business in New York, extraterritorial values cannot be taxed by the State even in the absence of a Federal statute preventing it from doing so. New York, in taxing corporations doing business within New York and outside of New York, either separately or on a combined basis, uses a three-factor formula in order to allocate income of corporations to New York. Standard claims that New York is taxing income earned by Caribbean in Puerto Rico, but it did not show that anything more than allocated New York income is being reached by requiring Standard to file a combined report with Caribbean.

Congress, prior to the enactment of Tax Reform Act of 1976, P.L. 94-455, did not prohibit the States from taxing income of corporations allocable to them by excluding from Federal taxation income claimed to have been earned by certain qualified corporations in Puerto Rico. Nor did it do so thereafter by granting such qualified corporations tax credits against their United States taxes. New York, by taxing income of a New York corporation not shown to have been earned by a subsidiary in Puerto Rico, does not frustrate the congressional intent to encourage investments in Puerto Rico by Federal tax incentives.

Standard has pointed to no statute, court decision or congressional history which shows that Congress intended to preempt States from requiring a corporation doing business in the taxing State from including in a combined report a corporation doing business in Puerto Rico, with the purpose of imposing taxes solely on income which is properly allocable to the taxing State. Without a showing that extraterritorial values are being taxed, Standard's claim that New York has been preempted from requiring it to file a combined report with Caribbean is simply without merit and presents no substantial Federal question.

The inclusion of Caribbean in a combined report which does not result in reaching income other than that which is the proper and accurate reflection of income earned in New York does not violate the Due Process Clause of the United States Constitution. No showing has been made that the taxes imposed on Standard is in violation of the tests for valid state taxes announced in *Complete Auto Transit v. Brady,* 430 U. S. 274, 279 (1977). Nor has appellant claimed that other taxpayers similarly situated are not subject to the provisions of New York Tax Law, § 211(4).

The appellant's claim that the New York State Tax Commission required Standard to file a combined tax re-

port with Caribbean beginning in 1976 resulted only from the change in the form of the tax benefit provisions in the internal revenue code is without support and has no relevance. The fact that the State Tax Commission did not require Standard to file such a combined report for previous years did not prevent the Tax Commission from requiring proper compliance with the New York Tax Law for the years in issue. As pointed out in the decision of the New York Supreme Court, Appellate Division, there was no usurpation of a legislative function by the Tax Commission here, a claim that included petitioner's argument below. New York Tax Law, § 211(4) clearly authorized the Tax Commission to require the filing of combined reports long before the years in issue in order to reflect tax liability properly.

CONCLUSION

Appellee submits that the question upon which this case depends is so unsubstantial as not to need further argument, and appellee moves the Court to dismiss this appeal, or, in the alternative, to affirm the judgment entered in the case by the Court of Appeals of the State of New York.

Dated: Albany, New York
April 14, 1987

Respectfully submitted,

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